

COURT OF CHANCERY
OF THE
STATE OF DELAWARE

STEPHEN P. LAMB
VICE CHANCELLOR

New Castle County Court House
500 N. King Street, Suite 11400
Wilmington, Delaware 19801

Submitted: January 15, 2009

Decided: January 21, 2009

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***RE: Topspin Partners, L.P., Topspin Associates, L.P., James W. Harpel Jr. 40 Trust, Anthony C. Harpel 40 Trust, and James Harpel v. RockSolid Systems, Inc., Donald Ritzman, and Richard Weir
C.A. No. 4275-VCL***

Dear Counsel:

I have read the briefs regarding the plaintiffs' motion for a temporary restraining order and have considered counsel's arguments by telephonic conference held January 15, 2009. For the reasons set forth herein, the plaintiffs' motion will be denied and the parties are directed to present the court with a negotiated status quo order.

I.

RockSolid Systems, Inc. is a small company in the process of developing a not-yet-completed software product, based on technology owned by a nonparty to this lawsuit. This case arises out of a letter agreement¹ dated October 16, 2007, between the plaintiffs, Alfred R. Berkeley III (not a party to this action), and RockSolid. That letter agreement was signed on behalf of RockSolid by defendant Richard Weir, its President and CEO, and modified an earlier stockholders'

¹ Compl. Ex. E.

agreement.² The letter agreement provides that the \$1.25 million proceeds of a sale of Series A Preferred Stock to the plaintiffs were to be held in a segregated account from which no funds were to be disbursed without board approval, including the consent of the plaintiffs' board representatives. Without such approval, the funds were "not in any way to be spent or otherwise utilized" by RockSolid. If the funds were not approved for disbursement by March 1, 2008, TopSpin was obligated to offer to redeem the shares of Series A Preferred Stock purchased in that sale at the purchase price paid.

Several things went wrong. First, the separate account was never created and the \$1.25 million was never segregated. Second, although no approval to disburse the funds was ever made by the board of directors, TopSpin never offered to redeem the preferred stock. Instead, its officers began to use the funds for general corporate purposes, including paying their own salaries and related benefits costs, paying for the services of a software developer, and meeting obligations to a related joint venture. According to the oral representation of the defendants' counsel during the teleconference, less than \$300,000 of the \$1.25 million remains. When confronted with their failure to comply with the October 2007 letter agreement, the individual defendants responded that they "forgot" about the contractual restrictions on the funds, and that they "messed up."³ Meanwhile, the board of RockSolid, which consists equally of representatives of the plaintiffs and defendants, is now allegedly deadlocked.

The plaintiffs brought suit seeking a variety of remedies, including dissolution of RockSolid, the appointment of a custodian or receiver to manage the winding up of the corporation, and redemption of the Series A Preferred Stock as contemplated by the letter agreement. The plaintiffs also seek a temporary restraining order, which is the subject of this opinion, to prevent the further dissipation of the funds in question.

² Compl. Ex. D.

³ The defendants also respond that the plaintiffs, as a result of their delay and failure to make a demand for redemption of their Series A Preferred Stock have waived their rights under the letter agreement. Without deciding the issue, the court notes that the Amended and Restated Stockholders' Agreement which the letter agreement modifies contains a "No Waiver" provision. Stockholders' Agreement § 16.

II.

“The essential predicate for issuance of [a temporary restraining order] is a threat of imminent, irreparable injury. Once that is shown, the remedy ought ordinarily to issue unless the Court is persuaded (1) that the claim asserted on the merits is frivolous or not truly litigable, (2) that the risk of harm in granting the remedy is greater than the risk to plaintiff of denying it, or (3) that plaintiff has not proceeded as promptly as it might, [and] has therefore contributed to the emergency nature of the application and is guilty of laches.”⁴

In support of their application, the plaintiffs offer *Brinati v. Telestar, Inc.*⁵ for the proposition that the threatened dissipation of corporate assets can constitute irreparable harm where the plaintiff holds preferred stock with enforceable redemption rights.⁶ From the pleadings and the representations of the defendants’ counsel it appears that the defendants are even now expending the funds in question, in apparent violation of the letter agreement. The defendants’ counsel represented to the court that RockSolid is spending approximately \$100,000 per month, and the disputed funds are the company’s only source of cash. Thus, the balance of the funds, in the absence of some restriction by the court, may be quickly dissipated. That money was invested by the plaintiffs and was designated as the source from which to redeem their stock. Once it is dissipated, there is no other source of liquid assets available to pay any part of that redemption preference. Moreover, the defendants’ counsel has represented to the court that the individual defendants are not “persons of means” and are unlikely to be able to finance the company through another month, let alone make good on the already expended funds. Assuming, without deciding, that the plaintiffs have met their burden to show the threat of imminent, irreparable harm, the court will move on to the other factors in the test.

For the purposes of an application for a temporary restraining order, the analysis of whether the claims asserted are meritorious requires nothing more than a showing “that a colorable claim has been made out if the facts alleged are true.”⁷

⁴ *Cottle v. Carr*, 1988 WL 10415, at *3 (Del. Ch.).

⁵ 1985 WL 44688 (Del Ch.).

⁶ *Id.* at *4-5.

⁷ *UIS, Inc. v. Walbro Corp.*, 1987 WL 18108, at *1 (Del. Ch.).

The plaintiffs have easily met this low burden. The defendants admit that the plaintiffs had a contractual right which was violated. The defendants' defenses presently appear to center around claims of acquiescence, waiver, and estoppel for the plaintiffs' alleged delay in bringing this suit. These are all questions of fact to be determined at trial. But there is little question that the plaintiffs have stated a colorable claim, and that if the facts alleged are true the plaintiffs will be entitled to relief.

The last two factors, the balance of the equities and the concern for laches, prove to be a burden the plaintiffs cannot at present meet. In this case, the two are intertwined. If the plaintiffs' motion is granted, and an order freezing the assets of the company issued, the company will effectively be out of business. The defendants, meanwhile, suggest that their software product is only a few weeks from being completed. Thus, a good deal of value which the defendants claim to have long labored to create will be lost to RockSolid. At the same time, the plaintiffs' delay in bringing this action gives the court cause for concern. The plaintiffs were aware as of March 2008 that no call for redemption, which the company was required to make, had come. They could have at that time demanded that their contractual right of redemption be satisfied. If they had met with resistance or foot-dragging, they could have then sued to force the company to redeem their stock. But they did not choose that course. Instead, they only just brought this suit, ten months after their right of redemption matured.

The court, as a result, is somewhat chary of the plaintiffs' motivation. The defendants suggest that the plaintiffs simply bided their time waiting for the software product to near completion, and now wish to steal the software code out from under RockSolid by means of this lawsuit, keeping all the potential profits for themselves. The plaintiffs' slowness to bring this suit makes this contention plausible. It may be that there is no truth to the accusation of laches, but the court will only be able to make that determination on a full record. In the meantime, the court must at least consider that the plaintiffs' delay in seeking relief makes inequitable the severe potential consequences of the temporary relief they seek. For these reasons, the court will not enter a temporary restraining order in the form requested by the plaintiffs at this time.

III.

The court finds that the plaintiffs and RockSolid are entitled to protection in the form of a status quo order. Such an order should be designed to preserve intact as much as possible of the RockSolid business, including its expectations for the software under development. At the same time, it should seek to limit the expenditure of the disputed funds to those needed to support the minimum level of ordinary course activity at RockSolid. All expenditures over a set dollar value should require the agreement of the parties (or the board of directors) or court order. The court directs the parties to negotiate such a form of status quo order, not unlike the one proposed by the defendants in their opposition to this motion, and present it no later than January 23, 2009. In the meantime, the defendants should continue to limit use of RockSolid's cash to those ordinary course expenditures required to maintain its status as an ongoing enterprise.

* * *

For the reasons set forth above, and subject to the direction found in Part III hereof, the motion for a temporary restraining order is DENIED. IT IS SO ORDERED.

/s/ Stephen P. Lamb
Vice Chancellor